Association française des marchés financiers

FINANCIAL MARKET PROFESSIONALS

AMAFI / 19-33
18 March 2019

AMAFI ANSWER TO FSB CONSULTATION ON THE EFFECTS OF FINANCIAL REGULATORY REFORMS ON SMEs FINANCING

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the new transparency policy approach of the FSB and is keen to contribute to its consultation on the effects of financial regulatory reforms on SMEs financing as it is a key topic for its members.

While the issue of SMEs financing, both at the recent FSB roundtable and in the consultation, is rather addressed from a banking point of view, it also appears necessary to consider the issue from a financial market perspective as markets have an important role to play in SMEs access to capital.

Introduction

As highlighted during the December 2018 FSB roundtable, the definition and characteristics of SMEs vary across jurisdictions. Besides, the definition of an SME also differs whether it is considered from a banking/lending perspective or from a financial market one. From a financial market perspective AMAFI considers that an SME is defined by a market capitalization of approximately 3 billion euros. Below that threshold, one can notice that SMEs could face some difficulties in accessing financial markets.

As post-crisis regulations put more constraints on bank financing, financial markets have a bigger role to play in financing the economy, and especially SMEs. This is the reason why the European Commission through the Capital Markets Union (CMU) project has started to reform the EU financial market regulatory framework to notably ease SMEs access to finance at different stages of their growth.

In order to reach that objective, we believe that reforms should focus on widening the investor base rather than easing the listing of companies. An ECMI study from December 2017 highlights that equity markets represent 150% of the GDP in the US and only 70% in the EU. Yet, this gap does not result from the number of listed companies given there are more listed companies in the EU than in the US.

In light of its profile and membership, the Association focuses its answer on question 5 of the consultation: what other G20 financial reforms or other domestic financial regulations (if any) may have impacted SMEs and how?

The impact of the existing financial markets regulatory framework on SMEs financing

Reflecting on the activities of AMAFI's members, the EU regulatory framework for financial markets related to SMEs financing mainly revolves around MiFID II/MiFIR, MAR together with the CMU which encapsulates a number of initiatives including SME growth markets, Prospectus, simple, transparent and standardised (STS) Securitization and PRIIPs.

Generally speaking, we believe the CMU is far from being completed, with only few legislations implemented to-date, and of which some do not produce the expected results. Reflections around the future of the CMU and the existing regulatory framework for financial markets appear crucial especially with the UK, so far the main financial center of the Union, leaving the EU.

More specifically, we would like to focus our analysis on the following legislations:

- **The STS Securitisation Regulation** which entered into force in January 2018 is far from producing the expected results. On the one hand the legislation has created too many constraints resulting from too heavy prudential requirements and on the other hand it is not ambitious enough.

  Indeed, the European ecosystem appears less favourable than the one in the US where securitisation plays a central role in SMEs access to capital. One key difference revolves around the establishment of Government Sponsored Enterprises (GSEs) in the US which provide a rather explicit guarantee that enables to remove extremely important amounts of residential loans from banks balance sheets through the securitization process. We consider the creation of similar GSEs, together with efforts to limit divergences in member states bankruptcy laws, as necessary pre-conditions for the securitization market to take-off in Europe.

- **The SME growth markets legislation**, recently agreed by EU institutions, aims to simplify a number of requirements from MAR and from Prospectus perceived as regulatory hurdles for SMEs to access capital. In the final text, the market soundings exemption for private placement has been extended to all trading venues and the benefits of liquidity contracts will apply to all issuers while respecting national accepted market practice. A template will be created to enable issuers that do not benefit from a national accepted market practice to enter into such an arrangement. AMAFI is very much supportive of these amendments and considers they should ease SMEs access to financing, and help reduce the cost of their access to capital.

- **MiFID2** and in particular Article 13 of the Commission Delegated Directive (EU) 2017/593 modifies the economic model of financial analysis for equity markets and has a detrimental effect on SMEs financing. The former and largely used "bundled model" is no longer possible. Henceforth, research has to be paid by asset management companies independent of the transactions they carried out with their brokers, at least when acting on behalf of client portfolios.

  There is a large consensus among issuers, asset management companies and research providers that, given the new rules, the total amount paid for research will dramatically diminish in the coming years and accordingly the supply of research. This will particularly impact the supply of research for SMEs because research providers will no longer be able to finance research on SMEs in a context where cross-subsidization is not possible. As there is no evidence that a new economic model will emerge, there is a risk of severe reduction in the availability of research on SMEs. This would seriously impact the attractiveness and liquidity of listed SMEs.

- **MiFID 2 and PRIIPs**, we would like to emphasize that certain provisions have resulted in making the selling of certain financial products more constraining, more expensive as well as more risky, therefore having a negative effect on SMEs financing.

The necessary reform of taxation on savings and the development of alternative sources of financing

Beyond our assessment of the impact on SMEs financing of the existing European financial regulatory framework, we would like to stress the need to reform the taxation on savings in order to provide further financial resources to the financing of SMEs.

Indeed, while the reputation of a company plays a central role in its ability to attract capital, it rarely goes cross-borders. As a consequence, SMEs very much rely on domestic capital, even though they have a strong reputation. In that context, it appears necessary to amend and harmonize existing national legislations dealing with taxation on savings in order to incentivize the allocation of savings towards a more long term and risky financing for SMEs.

Additionally, we consider future reforms should facilitate the development of patient investors, especially pension funds, which would allocate capital towards more long term and risky projects.

Beyond the traditional sources of financing, we consider the development of alternative sources as particularly promising from the moment on they are properly regulated. In that context, AMAFI created a dedicated working group in order to contribute to ongoing legislative work on ICOs at EU and French levels.

In a nutshell, the Association considers that new technologies can contribute to reducing internal and collective costs of financial market activities at various levels of the value chain (execution, clearing, settlement, custody, KYC, etc.). Tokens represent an opportunity for banks and investment firms to help their clients develop new ways of raising funds to finance their growth.

Nevertheless, one should bear in mind that risks already identified and mitigated (money laundering, frauds, cyber-criminality, market abuse) in regulated financial activities are inherent, probably at a larger scale, to this new environment even if, in some cases, technology can be a means to reduce risks. It appears necessary to ensure that the development of tokens does not create major financial crisis or scandals which would end up with a loss of public confidence in financial markets. Going forward, it will be key to find a good balance between innovation and investor protection.